Large Scale Agribusiness Investments and Implications in Africa: Development Finance Institutions' Perspectives

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Abstract

Agricultural sector in Africa has increasingly been the recipient of significant amount of attention from investors, in the form of large scale agribusiness projects, and the concomitant demand for land. Development Finance Institutions (DFIs) such as the African Development Bank (through its private sector department) and the World Bank Group (through IFC and MIGA) have been providing financing for many projects in the sector. In fact, DFIs provided about USD 12 billion globally between 1998 and 2008, with the AfDB accounting for most of the DFI financing of projects in Africa. This paper analyses the additionality – that is, bringing development-relevant qualities to projects that cannot be contributed by commercial lenders. We pay particular attention to land governance, given the fact that land is the most important factor of production in agribusiness projects, and the considerable amount of controversy surrounding it. The high level of DFI financing for private sector projects presents both a challenge and opportunity. The institutions need to justify that their investments in profit-oriented private sector operations are consistent with their poverty reduction mandates. Fortunately, there is ample opportunity to demonstrate additionality by bringing features that maximize development outcomes of projects. This paper contributes to the debate on large agribusiness projects and land concessions by drawing from the actual experiences of the AfDB in the field to demonstrate how DFIs can maximize development outcomes of projects without compromising commercial viability.
1. Introduction

Agriculture is the dominant source of livelihood in Africa, especially in low-income rural areas. About 70% of the population is directly employed in the sector, and it accounts for approximately 30% of the region’s gross domestic product (GDP). Therefore growth in agricultural productivity is likely to have a direct impact on economic growth with strong effects on poverty. Furthermore, agricultural productivity growth resulting from increased investments (both public and private), when coupled with input and output market development, can set the stage for the same structural transformation of agrarian economies that has immensely benefitted other developing regions, most recently Southeast Asia.

Thus the important role of agriculture in achieving inclusive growth is no longer contested. African countries adopted the Comprehensive Africa Agriculture Development Program (CAADP) in 2003, under the auspices of the African Union’s New Partnership for Africa’s Development (NEPAD), which requires them to devote 10% of their national budgets to agriculture and target to achieve a sector growth rate of 6% per annum by 2015. This would bring annual public investments to just shy of USD 20 billion, based on the government expenditures for 2010. However, most countries are yet to achieve these targets. For example, only 9 out the 29 countries for which data were available reached the targeted 6% sector growth rate in 2010 (WDI 2012). Official development assistance (ODA) to the agriculture sector has also remained constant at 4% of total ODA over the past two decades; valued at USD 8 billion in 2009 (OECD 2009).

This investment gap underscores the importance of private investments in the sector, and the subsequent growing need for development finance institutions (DFIs) support to these investments. While still small in absolute terms, the share of total foreign direct investments flows devoted to agriculture has started to increase, as has DFIs’ contributions encouraging private investments in the sector. Between 1998 and 2008, DFIs invested about USD 12 billion in the agriculture sector through private sector investments (non-sovereign operations). The AfDB was the leading DFI in the African
region, contributing 7%, almost USD 1 billion, of total DFI investments in agriculture (AfDB 2011; World Bank 2010).

Our paper’s focus is agribusiness and encompasses the whole spectrum of the agriculture value chain. This includes mainly, inputs (seeds, fertilizer, pesticides, herbicides and animal feed), primary production (crop and livestock husbandry), processing (milling, storage, packaging and handling), marketing and distribution. We define an agribusiness as any operation along this value chain that is conducted on a commercial basis. It must be acknowledged that agribusiness is necessarily a subset of agriculture since other aspects of the latter, such as extension services and land registration, are usually public in nature. The total size of agriculture, including agribusiness, in sub-Saharan Africa was approximately USD 313 billion in 2010, and is expected to reach USD 1 trillion in 2030 (World Bank 2013).

This paper analyses the additionality that DFIs bring to the agribusiness sector. By additionality, we mean the specific features that DFIs bring to private sector projects that commercial banks are unable or unwilling to bring. Such “additional” aspects of DFIs’ support are important not only to ensure that highly developmental projects are fully funded, but also, to enhance the development outcomes of supported projects through the introduction of well-rounded design and improved operation.

One of the salient aspects of the growth of the agribusiness sector in recent years has been the attendant increase in demand for land in Africa (Oxfarm 2012). But while this demand represents an opportunity, it often comes with risks such as land tenure insecurity, land market distortions, increased vulnerability to food price shocks, loss of biodiversity and environmental degradation. This means that the potential benefits expected from foreign direct investments in the sector are not always guaranteed. Therefore the paper pays particular attention to land acquisitions for agribusiness investments with the objective of highlighting opportunities for DFI additionality. Given the significant role of DFIs as financiers, and the role they can play as honest brokers, they possess the capacity to bring about various kinds of design improvements in agribusiness projects that other commercial financial institutions cannot match. These include adoption of project design features such as proper land valuation, tenure security, enhancing inclusiveness, strengthening food security and stringent monitoring
of environmental and social effects. Beyond land governance aspects, DFIs bring other forms of additionality, including direct (providing equity and debt financing) and indirect resource mobilization (reducing political and commercial risk), as well as political risk mitigation.

The rest of the paper is structured as follow: section 2 provides an overview of African agriculture, with detailed analysis of the nature and determinants of recent land demand; section 3 discusses the potential development outcomes from the agribusiness sector. Section 4 provides an analysis of the various forms of additionality that DFIs brings, namely, political risk mitigation, financial additionality and improvements in design and operations. Section 5 concludes the paper.

2. African Agriculture

Agricultural productivity in Africa has grown much more slowly relative to other regions (figure 1). A key indicator of agricultural productivity is yield (crop output per area). While other regions have doubled their average yields between 1970 and 2010, the growth in yield in Africa is barely perceptible. For most of that period, Africa’s agricultural sector received public support directed to agricultural parastatals as subsidies, or to farmers as input subsidies (Bates 1981). These policies had limited effect on productivity as they did not directly address the underlying structural constraints to agricultural production such as poor infrastructure and high risk. Instead, they contributed to the accumulation of unsustainable public debt. The sector liberalization programs of the 1980s and 1990s, whilst succeeding at lessening the adverse budgetary impacts of public interventions, also had negligible effects on the fundamental productivity constraints (Varangis and Schreiber 2001; Coulter and Poulton 2001).
Figure 1: Cereal yield in regions over time.


2.1. Recent Agribusiness Investments

Recently, the agribusiness sector in Africa has started to challenge mining and hydrocarbons in terms of attracting interest from foreign investors. Foreign direct investment (FDI) inflows to Africa went from about USD 1 billion in 1990 to over USD 43 billion in 2011. The share of the FDI going to the agribusiness sector in Africa, though relatively small, is increasing over the second half of the last decade. It went from approximately USD 2 billion in 2011 to about USD 5 billion in Africa in 2011 (table 1).

Table 1: FDI (Greenfield) in the agribusiness sector across developing regions.

<table>
<thead>
<tr>
<th>Region</th>
<th>2010</th>
<th>2011</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Greenfield Investments</td>
<td>Total Greenfield in agribusiness</td>
<td>Total Greenfield Investments</td>
<td>Total Greenfield in agribusiness</td>
</tr>
<tr>
<td>Africa</td>
<td>88,918</td>
<td>1,888</td>
<td>82,315</td>
<td>5,184</td>
</tr>
<tr>
<td>East &amp; Southeast Asia</td>
<td>213,770</td>
<td>n/a</td>
<td>206,924</td>
<td>n/a</td>
</tr>
<tr>
<td>West Asia</td>
<td>60,011</td>
<td>1,443</td>
<td>69,151</td>
<td>3,783</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>120,113</td>
<td>6,258</td>
<td>138,680</td>
<td>10,632</td>
</tr>
<tr>
<td>South Asia</td>
<td>62,899</td>
<td>n/a</td>
<td>68,019</td>
<td>n/a</td>
</tr>
</tbody>
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†These cereal are barley, buckwheat, canary seed, fonio, maize/corn, millet, mixed grain, oats, quinoa, paddy rice, rye, sorghum, triticale, wheat and other cereals.
The main commodities involved in the agribusiness investments in Africa are rice, palm oil, sugarcane (for sugar and ethanol) and timber. These investments have been spurred proximately by recent increases in food and energy prices (Wouterse et al. 2011) which in most cases translated into higher commodity prices. For instance, following a flat trend in the prices of rice and palm oil for most of the past three decades, an upswing in the prices is easily discernible around 2008 (figures 2 and 3). An upward trend is also visible for timber products. And whilst the price of sugar does not show any upward trend (figure 4), investments in sugarcane were strong over the last 5 years, responding to increasing demand for ethanol (figure 6) which is in turn driven by an increase in the price of oil (figure 7). The trend in the sugar market also reflects (western) governments’ decision to subsidize bio-fuel production leading to increased sugarcane cultivation. Finally, in Africa, the sugarcane market has links to electricity markets, given that bagasse, the sugar and ethanol bi-product, is increasingly used as fuel in electricity production.

Concurrent to increasing agribusiness FDI in Africa, the commitment of agricultural land to foreign owned agribusiness firms has increased. These land allocations are driven by a number of factors including, on the demand side, what are sometimes referred to as the 3-Fs – food, (animal) feed and fuel (figures 8, 9 and 10). But increasingly, supply side factors are playing a more deterministic role, whereby investments are driven by factors such as water and agricultural land scarcity in FDI source countries. For instance, many agribusiness investors in Africa are from Middle Eastern countries (e.g. Saudi Arabia in Sudan) with limited supply of arable land and significant water scarcity.
Figure 2: Historical (monthly) price of rice between 1980 and 2011.


Figure 4: Historical (monthly) price of sugar between 1991 and 2011.


Figure 3: Historical (monthly) price of palm oil between 1980 and 2011.


Figure 5: Historical (monthly) price of wood products between 1980 and 2011.


Figure 6: Retail price of Ethanol (USA).

Source: US Energy Department (2013)

Figure 7: Historical oil price (European Brent spot price).
**Figure 8:** Land dedicated to sugarcane cultivation in Africa and world-wide (million ha).


**Figure 9:** Land dedicated to rice cultivation world-wide in Africa and worldwide (million ha).

2.2. Land Demand and Allocation

Land is arguably the most important factor of production for agribusiness projects. Consequently, agribusiness projects would tend to gravitate towards regions where agricultural land is abundant. The size of agricultural land in Africa is approximately 1 billion hectares (ha) and has grown at a rate of 0.4% per annum over the past decade, a slight increase over the 0.2% growth in the preceding decade. Agricultural land is roughly equally distributed across the various sub-regions of Africa (26% Eastern; 24% Western, 21% Northern; 15% Southern and 14% Central). Arable land (i.e. land suitable for cultivation) currently constitutes about 20% of this agricultural area at the continent level. This share has been steadily increasing at a rate of 1% per annum. The largest share of arable land is in West Africa (37%), followed by East Africa (25%). Northern, Central and Southern Africa, respectively, have 19%, 11% and 8%. In terms of both agricultural and arable land, the top-ten land abundant African countries are Sudan, Nigeria, South Africa, Niger, Algeria, Ethiopia, Tanzania, Mali and Mozambique (FAOSTAT, 2012).
Africa’s share of arable land is only 16% of the total global arable land (figure 11). However, only about 20% of its arable land is under cultivation at a given point in time (Mo Ibrahim Foundation 2011). On the other hand, future expansion outside of Africa is limited since, as the World Bank estimates, about half of all the land suitable for cultivation that is currently uncultivated or is part of some protected reserve is in Africa (World Bank 2011). In fact, arable land is actually decreasing in industrialized countries (Arezki, et al 2011). For instance, the FAO estimates that the size of arable land in major industrialized countries fell from approximately 450 million in 1990 to 405 million hectares in 2011 (FAOSTAT, 2013). Consequently, the African region will continue to attract investments in the agribusiness sector.

Figure 11: Global arable land and Africa’s share.


However, the relative abundance of land in Africa is not a phenomenon that is destined to persist in perpetuity. The region’s population is currently growing in excess of 2% per annum, and is projected to have doubled, reaching the 2 billion mark by 2045. The high urbanization growth rate of over 3% per annum will have transformed the continent to majority urban by 2031, mitigating pressures on agricultural land but only to a limited extent given that Africa’s rural population is expected to continue to grow until at least 2048 (United Nations Population Division 2012). What is more, this growth in rural population is expected to be more

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3 This includes countries in the following regions: North America, Western Europe, East Asia and Australasia.
pronounced in countries well-endowed with arable land; the same countries being targeted for investments in the agribusiness sector.

A further complication is the political economy of land ownership and land governance in Africa. Aside from being a factor of production, land is viewed as a heritage which in most African societies is communally-owned and managed, and passed from generation to generation. In Africa, a history of involuntary relocation without compensation from prime agricultural land during the colonial era adds a socio-political dimension to current trends in land demand and allocation. As a result, the transfer of land to foreign investors, which entails resettlement of local communities, or invades nomad territories, is highly sensitive politically and socially. But even when land allocations to foreign investors do not involve relocation, they could still be perceived as some form of neo-imperialism (Robertson and Pinstrup-Andersen 2010), especially when they involve carelessly crafted lease agreements that are too open-ended and do not involve proper valuation of the land. Of late, the transformation of rain forests and game reserves into arable land has been cause for concern from environmental and climate change perspectives. Therefore while the financial case for land transfer to foreign investors may be evident, it is important that socio-economic and political considerations are adequately heeded, to avoid the labeling of such transfers as “land-grabbing”. From a development perspective, it is crucial that at the minimum, land transfers involve a ‘fair’ valuation of the land; and where resettlement is involved, that project affected persons are adequately compensated.

Investment trends in the agribusiness sector have affected both the scale and complexion of the demand for land in Africa in recent years. In West and Central Africa, approximately 7.8 million hectares (2% of total agricultural land in 2009) were awarded to foreign investors between 2006 and 2010 (Genetic Resource Action International 2012). In Mozambique alone, about 2.7 million hectares were allocated to investors between 2004 and 2009 (Oakland Institute 2011), representing 5 percent of the total agricultural land in Mozambique in 2009. East Africa, in particular Ethiopia and Sudan, has similar quantities of land allocated to investors (Cotula et al. 2009). This scale of demand for land in Africa is unprecedented.

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4The land awarded to investors took place in Benin, Gabon, Ghana, Guinea Conakry, Liberia, Mali, Nigeria, Democratic Republic of Congo, Senegal and Sierra Leone. Actual investments are yet to take place in all these land concessions.
3. Potential Development Effects in Agribusiness

Most agribusiness projects have the potential to produce significant positive development effects. These include employment and income generation either directly from the agribusiness firm’s nucleus plantation and processing facilities, or through the implementation of out-grower schemes (also known as contract farming). They also include transfer of technology in the form of introduction of improved seeds, pesticides, chemical fertilizers and better storage facilities which will boost agricultural productivity. In some cases, the increase in output from greater productivity is likely to turn some food-importing countries to net producers, with positive food security and balance of payments effects. Improvements and construction of infrastructure such as roads and irrigation systems, which can alleviate major growth bottlenecks and with significant spillover effects into other sectors, are also part of these effects.

However, the materialization of the above development effects is not always guaranteed. As already discussed, modern agribusiness projects require large amounts of land to take advantage of economies of scale. This could lead to conflicts when the land allocated to an agribusiness firm is contested. With inadequate land governance frameworks that leave farming households without security of tenure in many parts of Africa, land allocations to agribusinesses could potentially exacerbate existing household vulnerabilities. In many countries with poor governance, the process of granting land concessions is not always inclusive, nor does it allow for local communities to be consulted or given a voice in the process. Moreover, households could be involuntarily relocated from prime farmland without proper compensation. Even when land is properly allocated to investors, the vulnerability of farming households to income and food price shocks could be worsened if their access to land is restricted, and their ability to grow food crops is limited. Without proper safeguards, environmental degradation through deforestation, unsustainable use of water and loss of biodiversity are negative externalities that could accompany large scale investments in the agribusiness sector.

Major international organizations have come up with 7 principles for responsible investments in the agribusiness sector. These principles seek to safeguard food security, respect the
rights of all stakeholders, promote good governance, and enhance inclusiveness through broad sharing of benefits and accounting for environmental externalities of projects (Box 1). Development partners in the business of supporting agribusiness investment in Africa, in particular, must be cognizant of the potential risks and address them when designing projects. The investment principles outlined above therefore provide a basis on which DFIs can demonstrate their “additionality” by enhancing features that maximize the development impacts of projects.

**Box 1: Principles of Responsible Agricultural Investment.**

1. Existing rights to land and associated natural resources are recognized and respected.
2. Investments do not jeopardize food security but rather strengthen it.
3. Processes for accessing land and other resources and then making associated investments are transparent, monitored, and ensure accountability by all stakeholders, within a proper business, legal, and regulatory environment.
4. All those materially affected are consulted, and agreements from consultations are recorded and enforced.
5. Investors ensure that projects respect the rule of law, reflect industry best practice, are viable economically, and result in durable shared value.
6. Investments generate desirable social and distributional impacts and do not increase vulnerability.
7. Environmental impacts due to a project are quantified and measures taken to encourage sustainable resource use while minimizing the risk/magnitude of negative impacts and mitigating them.

**Source:** The United Nations Food and Agricultural Organization (FAO), the International Fund for Agricultural Development (IFAD), the United Nations Conference on Trade and Development (UNCTAD) and the World Bank, 2010.
4. DFIs’ Additionality in the Agribusiness Sector

The participation of DFIs in projects can bring attributes that are aligned with their development mandates that would not be adopted if only commercial investors were present. Aside from improving the quality of development results, DFIs participation could also be justified from a financial value-added perspective, or for political risk mitigation\(^5\) purposes, where their nature or mandate gives them exclusivity or comparative advantage in performing certain roles required for project bankability. We refer to these roles collectively as the “additionality” of DFIs\(^6\).

Financial additionality of DFIs in the agribusiness sector is confirmed by their active participation as lenders. The AfDB, for instance, has adopted several financing instruments to support agribusiness investments in Africa. It has approved direct financing to projects across all sub-regions of the continent and involving cultivation and/or processing of major commodities such as palm oil, sugarcane, timber and rice. For instance, in 2010 it approved 2 major agribusiness projects worth approximately USD 950 million\(^7\). In these projects, the AfDB provided an average of USD 50 million in non-concessional debt for an average tenor of approximately 12 years. The total amount of land involved in the transactions was 16,000 hectares on the nucleus plantations alone\(^8\). The AfDB has also provided indirect financing through private equity funds. For example, along with the Agence Française de Développement (AFD), it launched a USD 300 million private equity fund in 2010 with a focus on the agribusiness sector. And in 2012, it approved a USD 500 million fund-of-funds (a private equity that invests in other private equity funds) which is also focused on the agribusiness sector. Financial additionality in these investments stemmed mostly from the provision of debt at tenors not readily available on the market, filling funding gaps and providing ‘patient’ capital.

\(^5\) By political risk mitigation, we refer to the reduction in the likelihood of adverse government actions (e.g. expropriation, breach of contract and non-convertibility) against a project.

\(^6\) It should be pointed out that it is possible for a private project to exhibit high development outcomes where no additionality could materialize. This is possible because not all private sector initiatives require public interventions to ensure their contribution to development.

\(^7\) One of the projects did not get off the ground due to unrelated political instability.

\(^8\) This does not include the area that will be farmed by farmers in associated out-grower schemes.
Another DFI that has made significant investments in the agribusiness sector in Africa is the International Finance Corporation (IFC) of the World Bank Group. For instance, about USD 1 billion in annual investments goes to the sector, out of which approximately half (USD 550 million) is invested in Africa (IFC 2013). Other active DFIs in Africa include the European Investment Bank (EIB), the French Investment and Promotions Company for Economic Cooperation (Proparco), the Netherlands Development Finance Company (more commonly known by its Dutch acronym, FMO), and the German Investment Corporation (more commonly known by its German acronym, DEG).

But of particular interest to agribusiness investments are the roles that DFIs can play to improve development results. Private sector projects are by their nature, primarily designed to maximize profits for investors. But a broader view would consider all the stakeholders affected by the investment, and seek to maximize overall economic benefits. Aside from the private investors, other relevant stakeholders are local and central governments, as well as households whose livelihoods are likely to depend on the same or adjacent parcels of land. The recent proliferation of community level social responsibility initiatives notwithstanding, the scope for enhancing the development effects of commercially viable projects is often substantial, considering project design features may be improved or adopted to ensure that development outcomes are maximized. The following sections discuss these features.

### 4.1. Land Valuation

Recent evidence has shown that countries that are both land abundant and have poor governance are attracting the largest investments in the agribusiness sector (Arezki et al. 2011). This means that the various components of a land concession agreement that authorize and regulate agribusiness investments cannot be guaranteed to lead to equitable outcomes between the receiving country and the foreign investor. One major potential concern is whether the land allocated to investors is properly valued as reflected in the land lease or rental rate. In the context of active and well developed land market, the prevailing market prices would provide the best indications of the value of land in an area. A specific example is the case where an active or well-developed land auction exists. Unfortunately, this is not the norm in Africa where rural agricultural land is seldom traded; and individual ownership of farming land, though not a necessary condition for proper land valuation,
either not possible or restricted by the absence of well-defined land registration frameworks. A few cases exist on the continent of countries (e.g. Ethiopia) that have carried out extensive land registration reforms are moving toward developing functional land markets.

Given the absence of land market in most of rural Africa, valuing land in agribusiness projects is complicated and fraught with error. Notwithstanding this absence of land markets, undervaluation of land in agribusiness projects in Africa is evident from simple comparison of land lease rates attracted by projects in Africa to similar projects in Latin America. For example, whereas annual land lease rates in Africa are usually in the USD 0.15 to USD 10 per hectare, they can reach USD 250 to USD 300 per hectare in Latin America (Deininger et al. 2011). In some projects, the low lease rate essentially depict a situation where the return to land is far smaller than either the return to labor or capital, an outcome not consistent with land being the most important factor of production in agriculture.

Compensation for land must be reflected within the financial reality of investments, including all costs that are material to the project and the expected price of produce. It has often been argued that land valuation cannot be done in isolation, but in the context of the full financial returns associated with a project. The justification is that land might in fact be allocated free of charge to a private investor, as long as the tax system allows the state to recuperate the value of the land, or indeed, as an investment incentive in the same manner that tax breaks are used for this purpose. However, this argument does not undercut the need for appropriate land valuation since other sectors that do not have questionnaire issues of input valuation are also subject to government taxes. Moreover, there is no evidence that effective rates applied to agribusiness investments exceed that of other sectors. Therefore, extremely low lease rates are hard to justify when the financial rates of return are significantly higher than the risk weighted cost of capital. It is therefore important that frameworks are in place that allow the determination of investment profitability so that land valuation can be objectively assessed. The Evaluation Cooperation Group, for example, defines a financial rate of return that is between 350 and 700 basis point above the weighted average cost of capital to be “good”,

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9 The point here is not that they land value of a particular project in Latin America should be equal to some project in Africa. Rather, it is show the huge gulf in land rents when the price of the produce is determined on the world market and the total values of the projects in Africa are significantly high.
while anything in excess of this is considered “excellent” – in other words, above average or satisfactory in terms of commercial viability. Proper valuation of land should therefore require disclosure of financial projections of investments as part of the application for land concessions.

A few examples are useful to illustrate the challenges facing African countries with regard to land valuation. Mozambique is one of the most land abundant countries in Africa, with an agricultural area of approximately 50 million ha (4% of the continent’s total sum of agricultural land) and an arable land of 5 million ha. Due to this immense land wealth, it has attracted significant foreign agribusiness investments in recent years. These businesses have also benefited modestly valued land, subject to annual lease payments of USD 0.6 per hectare as of 2011. The lease rate is fixed, allowing for marginal increases annually, far less than the inflation rate and independent of the level of returns to investors. All payments are made directly to the central government, with no share for local communities or governments. In addition, the allocations of land to the agribusiness sector do not undergo competitive bidding. There is therefore almost a general consensus that the allocated land is undervalued (Deininger et al. 2011), as well as a possibility that some of it could have been acquired for speculative purposes.

Liberia is another country that has received significant investments in agribusiness. The country has an agricultural area of 2.6 million ha and an arable land size of 400,000 ha. It has a low population density of 35/km² and 52% of the population in rural areas. A 14-year civil war and resulting displacement has left a significant amount of land uncultivated. With the end of the civil war, the country has concluded several large scale concessions in the mining and agribusiness sectors. Learning from its own experience in dealing with unfair concessions in the mining sector (Gajigo et al. 2012), the government of Liberia recently changed its approach to negotiating concessions with the assistance of external experts. Another important improving feature of land concessions in Liberia is the establishment of a community development fund where part of the land lease payments is controlled by the local community. Additionally, there is an obligation to incorporate out-grower components that
benefit local smallholders. And finally, transparency is embedded in the system since all land concessions must be ratified by the country’s parliament\textsuperscript{10}.

In one case, the government asked the World Bank Group to oversee the land concession for a 10,000 ha palm oil plantation. Specifically, the World Bank Group oversaw the open bidding process\textsuperscript{11} involving various multinational companies, and the concession was subsequently awarded to a multi-national firm based in Ivory Coast. In this particular project, the land was valued at a lease rate of USD 12.5 per hectare per year (Government of Liberia 2011). While this value still falls short of the value of land in other developing countries in South America, it is an improvement over similar projects on the continent, in particular, those in Mozambique (Deininger et al. 2011). This demonstrates a DFI’s additionality in the sector.

The implications for improper land valuation are significant. Under-valuing land is likely to lead to misallocation of land and capital. It could also set countries into a perverse competition path where land values are systematically lowered in order to outbid neighboring countries. When the per-unit value of land is low, investors can request tracts of land far larger than what they intend to immediately develop, in order to benefit from the favorable land lease rates and other exemptions. It may also result in speculative land holding when individuals or businesses request land with no productive investment in mind but rather in the hope of higher prices in the future.

It is therefore important that DFIs ensure that the projects they finance at least have proper valuation of land. Given the governance challenges in many African countries and the fact that land concessions are usually signed before investors approach DFIs and commercial banks for financing, the likelihood of renegotiation of land concessions is low\textsuperscript{12}. While such renegotiations are not welcome by almost all parties to the original contract, they are

\textsuperscript{10} There is still considerable room for improvement in Liberia. For instance, while concession agreements are almost ideal on paper, there is a serious issue of capacity problem when it comes to implementation. For instance, both the Land Commission and the Ministry of Agriculture are significantly understaffed, and do not always have the resources to clearly demarcate land that have been allocated to investors in concession agreements.

\textsuperscript{11} It is worth pointing out that the bidding of land is not carried out in all projects.

\textsuperscript{12} At the African Development Bank, this problem is mitigated to some extent due to the presence of African Legal Support Facility (ALSF). The ALSF provides legal support to African countries that demand it in negotiation concessions in mining, agriculture, infrastructure and oil and gas. Assistance provided by ALSF, which is a unit independent from the AfDB’s private sector department, is not contingent on receiving financing from the AfDB.
sometimes necessary. DFIs’ endorsement of flawed contracts would set negative precedence, and introduces serious developmental and reputational risks. It should be pointed out that the ideal situation is for countries to have land policies in place that ensure that a framework exist for land concessions. The governance and agricultural sector departments, rather than the private sector investment departments of DFIs, are best suited to addressing this issue in relevant countries.

### 4.2. Food Security

One principle of responsible agricultural investments is ensuring food security. Food security is also a top target in the Millennium Development Goals. Despite Africa’s land abundance, any given piece of land has potentially numerous competing claims on it. Large scale agribusiness projects that require large tracts of land are therefore likely to reduce the amount of land available for small scale farmers. Given the continent’s low agricultural productivity per land unit, reduction in access to land will naturally translate into lower agricultural output, with direct implications for food security.

Recent increases in food prices have increased the vulnerability of many African households to food insecurity, especially net food buyers. In sub-Saharan Africa, most small scale farmers (up to 70% of farmers in some countries) are net food buyers (World Bank 2007). The ability to grow food crops as a form of insurance is essential for farmers' livelihoods as long as price shocks are frequent and governments have limited capacity to mitigate their effects (de Janvry and Sadoulet 2011).

There are a variety of ways to ensure that food security is not compromised in agribusiness projects. The best strategies are informed by local contexts as reflected in the environmental and social impact assessments for projects where expected impacts and at-risk groups are identified. One approach is to introduce programs to help increase local crop productivity when significant amounts of land have to be allocated to a project. This is necessary because existing farming systems in many parts of Africa are extensive in nature, i.e. they require large quantities of land to allow for fallow periods. By increasing local crop yields through farmer training and the introduction of modern inputs such as high yielding varieties and fertilizers, local production can be enhanced even if farmers have to end up with smaller parcels of land.
Such programs can be implemented as part of corporate social responsibility, which has now become a standard principle for firms (box 2).

**Box 2: Additionality in Action: Improving Food Security in an Agribusiness Project**

An example of an agribusiness project that protected local food security occurred in the Addax Bioenergy Project in Sierra Leone. This project involves the cultivation of sugarcane for the production of ethanol for export to the European markets and of electricity for the national grid. The total project cost was approximately USD 300 million, and uses 10,000 hectares of land to produce about 950,000 tons of sugarcane per annum. This sugarcane output is expected to produce about 90,000 m$^3$ of ethanol per annum. Given its size, there is a possibility that food security can be threatened due to the fact that farmers’ access to land would be restricted in the immediate vicinity of project. To counter this potential negative outcome, the project promoted the introduction of high-yielding rice varieties and Farmer Field Schools. These Farmer Field Schools improved farmer skills on the use of modern inputs such as fertilizers and compost making. The program was provided in cooperation with United Nations Food and Agriculture Organization (FAO) and the International Institute of Tropical Agriculture (IITA).

It needs to be pointed out that the Addax project is far from problem-free. There have been news reports of local households expressing dissatisfaction with the training received in the Farmer Field Schools and the level of extension support. It is therefore important that expectations are managed and expected benefits are not oversold during negotiations.

*Source: African Development Bank. 2010a.*

### 4.3. Land Tenure Security for Smallholders

The issue of food security is directly linked to security of tenure for land available to smallholder farmers. In most rural areas of Africa, there are overlapping claims on land. This means that land tenure is not well defined since ownership in terms of use, transfer and sale is not easily determined. At the rural household level, informal but long-standing customary practices determine use rights. While not codified, this informal system of land administration is well suited to traditional systems of agriculture that are characterized by shifting cultivation.

With the formation of modern nation states, several statutory laws based on civil and common laws are superimposed on these customary practices. The implication is that, without the knowledge of rural households, the government now owns the communal agricultural land in many countries and smallholders simply have use rights or privileges. As a result, the state can execute relocation for investment purposes either on a voluntary or involuntary basis.
Indeed, the concurrent presence of customary and statutory land regimes has had significant implications for tenure securities of rural farm households when there is significant demand for land from outside investors (Wily 2010). Because most statutory land regimes give ownership to the government, households have no legal protection from involuntary relocation from their land, which may then be allocated to investors. And when compensation is offered in such circumstances, its valuation is restricted to investments made in structures, crops and trees but does not include the underlying value of land.

One way to address this challenge at a policy level is to carry out land registration where individual and household ownerships are recognized as an important step in reducing tenure insecurity and household vulnerability. Some countries in Africa have carried out land registration programs. One example is Ethiopia, a country which has been the target of major agribusiness investments (Deininger et al. 2008); but the process has not reached most countries in Africa. This means that there are opportunities for DFI additionality in this area, to ensure that tenure security of rural households is not undermined even when statutory land regimes gives formal ownership to the state.

Consistent with the *Principles for Responsible Agricultural Investments* in box 1, DFIs should insist that agribusiness investments that involve the transfer of rural land to investors acknowledge existing claims to the land including those deriving from customary rights, ensure the involvements of claimants in land transfer negotiations, as well as fairly compensates legitimate claimants including for the value of the land. In box 3, we illustrate DFI additionality in an agribusiness project where customary rights were recognized and proper compensation was made. It should be pointed out that while land registration is necessary, it is not sufficient security of land tenure for smallholders, which underscores the need to fully understand the local context.
4.4. Local Linkages

Agribusiness projects can be designed so the returns accrue not only to the investors, but directly benefit the local community as well. Such an outcome increases the local ownership, and better aligns the interest of the community with that of the investors. Out-grower schemes provide a win-win strategy that DFIs can encourage in the agribusiness projects they fund. This form of contract farming, where the agribusiness firm agrees to buy local farmers’ produce over a given period, brings farmers into the global supply chain, while lowering the market risk they face. Farmers owning a wide range of land sizes can participate in such scheme as long as they can meet quality and other specifications from the agribusiness firm.

To ensure that farmers' produce meet certain minimum quality standards, almost all out-grower schemes include arrangements where the agribusiness firm provides inputs and training. Sometimes, the provision of these inputs requires financing by local financial institutions, which is often obtained using the off-take contract as collateral. Thus out-grower schemes can also contribute to reducing financial constraints for smallholders.

Box 3: Additionality of DFI in Land Tenure

Like many countries in Africa, foreign firms cannot own land in Sierra Leone. So the investors in the USD 300 million ADDAX Biotechnology project signed a long-term lease agreement with three local chiefdom councils covering the project area. The leases reflect the system of customary land practices in this region of Sierra Leone, which confers to chiefdom councils the custodianship of land. Chiefdom councils were represented by legal counsel during the negotiation of the terms. The term of the leases is 50 years with the possibility to extend an additional 21 years. In line with the recommendations of the Ministry of Agriculture, the project company will pay a total of USD 9/ha/year under the lease to be split as follows: 50% to landowners; 20% to the local district council; 20% to the chiefdom council; and 10% to the central government. There is a price review mechanism every seven years. In addition to the lease agreements, and in an effort to promote transparency and ensure that landowners receive a larger share of the benefits, the project company has gone beyond the lease requirements and will enter into acknowledgement agreements directly with landowners. This will entitle landowners to receive an additional USD 3/ha per year. This is the first time that this type of direct agreement has been made in Sierra Leone. Taking into account the leases and acknowledgement agreements, the project company will pay a total of USD 12/ha/year of which landowners will receive USD 7.50/ha/year. No claim is being made that the value of the land lease rate is optimal in this project. Rather, the key features of the above project are the consultative and inclusive process of the allocation and compensation.

Source: Gajigo and Stampini 2010 and Addax Project Appraisal Report, Ref. ADB/BD/WP/2011/37
The benefits of out-grower schemes for agribusiness firms are also non-trivial. An out-grower scheme represents a form of vertical integration through which the firm establishes a more stable and reliable supply chain, relative to dealing with numerous producers not bound by any contractual agreement. It also reduces search costs, which can result in higher margins.

For these benefits to materialize, it is essential that the set-up of the out-grower scheme is such that the interests of all stakeholders are protected. The contract needs to be fair in the distribution of risks and returns. Participating farmers that previously only had experience in subsistence farming will most likely require training in modern production methods with clearly defined contractual obligations. Gender consideration must also be mainstreamed in a formal way. For instance, women may be disadvantaged in their access to land, face societal constraints in growing certain crops, or be restricted in term of accessing proceeds from crop sales. Further, a well-implemented out-grower scheme needs to be cognizant of the economic context. For example, an out-grower scheme that results in monoculture would make households vulnerable to shocks to the food market.

In the case of out-grower schemes, guiding principles have been published by one of the UN's specialized agencies, FAO (FAO 2012). These guiding principles include the stressing of common objectives: transparency and fairness in contracts, proper disclosures of relevant information by all parties, fairness in risk-sharing and clear mechanisms for dispute settlements. These principles provide a basic framework for DFIs to incorporate in project designs when out-grower schemes are included in agribusiness projects they finance.

DFIs present ideal partners to play the role of facilitators of out-grower schemes and ensure that all parties benefit. This is due to DFIs honest-broker role. On the investors’ side, DFIs’ credibility is assured given their financial investments in projects. On the farmers’ side, DFIs have interests in their welfare due to their poverty reduction mandates, as well as their ongoing engagements with host countries that extend far beyond the outcomes of individual projects.
4.5. Environmental and Social Safeguards

The environmental and social management plans (ESMPs) of DFIs are crafted to ensure that the risks and impacts of projects are identified and properly mitigated. In addition to these strict requirements, numerous multinational investors are signatories to voluntary standards such as the Equator Principles\textsuperscript{13} whose goals are well aligned with DFI standards. However, the impact of these standards on project activities would be limited if close monitoring is not implemented. The efficacy of the ESMPs is also predicated on the monitoring capacities of the implementing firms. Significant capacity building may be required so that the rigor in the DFIs' ESMPs is reflected on the ground. Box 4 gives an example of a potential additionality for a project that is under review at the AfDB for possible financing.

**Box 4: Environmental and Social Monitoring at a Project under consideration by the AfDB for Funding.**

An agribusiness firm has approached the African Development Bank (AfDB) for funding a major project in East Africa. This project has a total cost of USD 440 million, and will require a land size of at least 8000 hectares. As is standard in all the private sector projects it funds, the project must adhere to the requirements of the AfDB’s rigorous environmental and social management system. In addition, strict disclosure requirements will be met, which includes the publication of the environmental and social impact assessment for a minimum period of 30 to 60 days. And given the fact that a few households will be displaced, the project must develop a resettlement action plan that complies with the AfDB’s involuntary resettlement policy.

In addition, the AfDB will be working with an independent research institution to implement a long-term monitoring of all major impacts of the project. This will include monitoring the socio-economic impact on local communities, greenhouse gas effects, impact on water resources and effect on local biodiversity. A rigorous impact evaluation will be incorporated in the monitoring and evaluation framework that will establish the link between the project components and outcomes at the level of households.

5. Conclusion

The agricultural sector presents a major opportunity for Africa given its share in most economies, as well as the region’s comparative advantage. The sector has been the recipient of significant amount of attention from investors, in the form of large scale agribusiness

\textsuperscript{13} The Equator Principles is a set of voluntary standard for commercial banks that provide project finance in developing countries. The standards include assessing and managing environmental risks that are close to, but not necessarily, equal with DFI standards. As of December 2012, about 77 financial institutions have adopted the principles.
investments, and the concomitant demand for land. Development Finance Institutions (DFIs) such as the African Development Bank have been providing financing for many projects in the sector.

This paper analyses the additionality – that is, bringing development-relevant qualities to projects that cannot be contributed by commercial lenders. We pay particular attention to land governance, given the fact that land is the most important factor of production in agribusiness projects, and the considerable amount of controversy surrounding it. The high level of DFI financing for agribusiness projects presents both a challenge and opportunity. The institutions need to justify that their investments in profit-oriented private sector operations are consistent with their poverty reduction mandates. Fortunately, there is ample opportunity to demonstrate additionality by catalyzing features that maximize development outcomes of projects. Some of the additionalities discussed in the paper go beyond financing and include ensuring that land is appropriately valued, the rights to land are respected including those deriving mostly from customary systems, ensuring that food security is not compromised, enhancing inclusiveness through out-grower schemes and implementing proper monitoring mechanisms. These additionalities are also consistent with the principles of responsible agribusiness investments that have been drawn by several multi-lateral development institutions.

This paper’s main contribution to the debate on large agribusiness projects and land concessions in Africa is the fact that it draws from the actual experiences of the AfDB in the field to demonstrate how DFIs can maximize development outcomes of projects without compromising commercial viability. As a result, its recommendations are grounded in actual experiences so that these private investments can be leveraged in to the continent’s benefit. It needs to be pointed out however that there is considerable scope for policy and operations relevant research. This include coming up with simple, rigorous and implementable methodology for land valuations in countries without well-developed land markets.
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**APPENDIX**

**Table A1**: Breakdown of countries by sub-region within Africa.

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